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The department has proposed the following ruling. In an ongoing effort to interact with and inform the public regarding issues relating to taxation, the Department of Revenue would appreciate your comments on the proposed document.

The proposed ruling is posted here for your review and comment. Comments received will be reviewed and revisions will be made accordingly. An e-mail link is provided at the beginning of each draft document for your comments or you may mail or fax your comments to:

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The deadline for comments is January 15, 2004

ARIZONA TRANSACTION PRIVILEGE TAX RULING

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DRAFT—12/5/03

(see Confidentiality Notice at end of document)

ISSUE:

Taxation of mobile telecommunications services.

APPLICABLE LAW:

Arizona Revised Statutes ("A.R.S.") § 42-5023 provides that, for proper administration of the transaction privilege tax statutes and to prevent evasion of Arizona transaction privilege tax, there is a presumption that "all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established."

A.R.S. § 42-5034.01(A) brings the levying and collection of all Arizona transaction privilege and excise taxes related to mobile telecommunications services into compliance with the Mobile Telecommunications Sourcing Act ("MTSA"), Pub. L. No.

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106-252, 114 Stat. 626, found in §§ 116 through 126 of Title 4 of the United States Code (“U.S.C.”).

A.R.S. § 42-5064 imposes transaction privilege tax on the business of providing intrastate telecommunications services in Arizona. The tax base is the gross proceeds of sales or gross income derived from the business of providing intrastate telecommunications services, including the gross income derived from tolls, subscriptions, and services for subscribers. Sales of Internet access services and telecommunications services purchased with a prepaid calling card or authorization number are excluded from the classification.

A.R.S. § 42-5252 permits the State to levy a telecommunication service excise tax (“9-1-1 tax”) imposed as a flat monthly fee for each activated wire and wireless service account to fund emergency telecommunications services.

A.R.S. § 42-6007 contains provisions analogous to A.R.S. § 42-5034.01(A) allowing local excise taxes to be collected on mobile telecommunications services pursuant to the requirements of the MTSA.

DISCUSSION:

The methodology for applying tax to mobile telecommunication services has become increasingly complex because service users are typically never in the same place. Users can originate a call in one jurisdiction and travel through multiple jurisdictions during the call. These circumstances make it hard to track the separate state and local jurisdictional segments of a particular call. Additionally, expanded home calling areas, bundled service offerings where taxable telecommunications services and other services or property are sold for a single price (e.g., wireless voice service sold with wireless Internet access), and other marketing advances make it increasingly difficult to assign each transaction to a specific taxing jurisdiction.

Before enactment of the new federal legislation, home service providers of mobile telecommunications services used several different methods to determine the situs of a service, including the exchange number, location of the first cell tower, and the subscriber’s billing address. Depending on the method used, some localities may have been receiving more or less tax revenues. Arizona transaction privilege tax was imposed on intrastate telecommunications services based on the location of the billing or service address as permitted under the U.S. Supreme Court’s decision in *Goldberg v. Sweet*, 488 U.S. 252 (1989). Arizona taxed any intrastate call that originated and terminated in this state if the billing or service address was in this state.

Congress addressed this problem of multijurisdictional commerce by introducing the MTSA. The MTSA establishes a uniform method for sourcing mobile telecommunications services for transaction privilege tax purposes by including a nexus requirement assigning all telecommunications taxes on consumers to one location

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called the customer's *place of primary use*. The place of primary use provides a single address for the purposes of state and local taxation for all wireless telecommunications services, including roaming charges. On July 28, 2000, President Clinton signed the MTSA into law.

On April 23, 2001, Governor Hull signed House Bill 2542 (Laws 2001, Ch. 202) into law. This legislation includes amendments to A.R.S. Title 42 to add tax provisions compliant with the MTSA. The amendments are effective for customer bills issued on or after August 1, 2002.

The MTSA does not affect the 9-1-1 tax imposed under A.R.S. § 42-5252. Pursuant to 4 U.S.C. § 116(b)(2), taxes applied to an equitably apportioned amount that is not determined on a transaction basis are not subject to the MTSA. The 9-1-1 tax is imposed at a flat monthly rate for each activated wire and wireless service account; it thus is not subject to the MTSA.

New Transaction Privilege Tax Sourcing Rules

Mobile Telecommunications Services

"Mobile telecommunications service" means a commercial mobile radio service, as defined in § 20.3 of Title 47 of the Code of Federal Regulations in effect on June 1, 1999. A commercial mobile radio service is any mobile service that is provided for profit and that makes interconnected service (meaning connected to a public switched telephone network) available to the public. A service is interconnected if it has a direct or indirect connection through automatic or manual means (e.g., by wire, microwave, or other technologies) to allow transmission or reception of messages or signals to or from points in the public switched network. A public switched network is any common carrier switched network whether by wire or radio, including local exchange carrier, interexchange carriers, and mobile service providers, that use the North American Numbering Plan for the provision of switched services.

Home Service Providers

A home service provider means the facilities-based carrier or reseller with whom the retail customer contracts for the provision of mobile telecommunications services. A home service provider's licensed service area is the geographic area in which the provider is authorized by law or contract to provide commercial mobile radio service to the customer. A reseller is a provider who purchases telecommunications services from another telecommunications service provider and then resells, uses as a component part of, or integrates the purchased services into a mobile telecommunications service. A "serving carrier," or a provider that services customers outside the home service provider's licensed service area, is not a reseller.

Place of Primary Use

The MTSA applies to Arizona's Telecommunications Service Excise Tax by providing that the excise tax does not apply to any charges for mobile telecommunications

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services billed to a customer where those services are provided, or deemed provided, to a customer whose place of primary use is outside this state. This application conforms the Telecommunication Service Excise Tax law to the MTSA to create a single, uniform sourcing rule for the purpose of state taxation pursuant to A.R.S. § 42-5252(C) and § 42-5034.01(A). If a mobile call is sourced to Arizona, no other state can tax it, even if the call originates or terminates in that state. Accordingly, the mobile telecommunications customer's place of primary use is considered the point of delivery of the mobile telecommunications service, and controls tax incidence for purposes of Arizona transaction privilege tax.

The new method assumes for taxation purposes that a mobile telecommunications customer makes all wireless calls at either the *customer's residential street address* or *primary business address*. A *customer* is the person or entity that *contracts* with the home service provider for telecommunications services. Nevertheless, if the *end user* of the services is not the contracting party, the end user of the mobile telecommunications services is deemed the customer for the purpose of sourcing rather than the contracting party, and the contracting party's billing address would thus not be considered the place of primary use. Resellers of mobile telecommunications services and serving carriers that merely service customers outside of their home service providers' licensed service areas are not customers for purposes of imposing the transaction privilege tax.

As the MTSA does not expand the scope of Arizona's taxing power, Arizona customers continue to pay transaction privilege tax on only intrastate mobile telecommunications services originating and terminating in the state. Also as before enactment of the MTSA, Arizona customers remain exempt from transaction privilege tax on charges for "roaming" calls made while traveling outside of Arizona. Customers with a place of primary use outside the state do not owe Arizona transaction privilege tax on their mobile telecommunications services where usage originates and terminates in this State.

Bundled Service Offerings

For bundled service offerings sold by a home service provider, the MTSA (4 U.S.C. § 123(b)) allows the imposition of state and local transaction privilege taxes on charges and fees that would not otherwise be taxed if unbundled and separately stated from taxable items.

Sales of Internet access are nontaxable pursuant to A.R.S. § 42-5064(A)(2). Thus, to ensure proper administration of the transaction privilege tax pursuant to A.R.S. § 42-5023 and in accordance with the MTSA, home service providers must either:

- (a) separately state the portion of their gross income that constitutes the nontaxable Internet access charges, or
- (b) reasonably identify Internet access charges in its books and records that are

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kept in the regular course of business.

Where a business is unable to identify a nontaxable sale of Internet access, e.g., as a component of a bundled service offering sold at a flat fee, the gross income derived from the offering will be presumed to be subject to transaction privilege tax.

Local Taxing Jurisdictions

Pursuant to the MTSA, carriers may use zip-plus-four or more digit codes to identify the local taxing jurisdiction where a customer lives. In some cases, the zip codes will not align with Arizona taxing jurisdiction boundaries. In that event, a carrier must designate one specific jurisdiction within such enhanced zip code for use in taxing the activity. Because the 9-digit-level zip codes do not always correspond with political boundaries, some degree of inaccuracy may occur.

The MTSA provides that the State may offer a database that assigns a local taxing jurisdiction code to each street address within Arizona. At the present, Arizona has not provided an electronic database for the purposes of assigning places of primary use. As such, a home service provider is held harmless from any tax, charge, or fee liability that otherwise would be assessed solely as a result of an incorrect designation of place of primary use, if it uses an enhanced zip code for assignment and exercises due diligence to ensure that addresses are assigned to the correct taxing jurisdictions. There is a rebuttable presumption that a home service provider has exercised due diligence if it demonstrates it has: (a) expended reasonable resources to implement and maintain an appropriately detailed electronic database of street address assignments; (b) implemented and maintained reasonable internal controls to promptly correct misassignments; and (c) used all reasonably obtainable and usable data pertaining to municipal annexations, incorporations, reorganizations, and any other changes in jurisdictional boundaries that materially affect the accuracy of such database.

This safe harbor for home service providers lasts until either 18 months after a nationwide standard numeric code has been approved by the Federation of Tax Administrators and the Multistate Tax Commission, or 6 months after Arizona or its designated database provider provides a database, whichever date is later.

If a home service provider's reliance on information provided by its customer is in good faith, a taxing jurisdiction must allow a home service provider to rely on the street address provided by its customer and not hold it liable for any additional taxes based on a different determination of the place of primary use for taxes customarily passed on to the customer as a separate itemized charge.

Customer Disputes

A.R.S. § 42-5034.01 creates a mandatory procedure for home service providers to resolve all customer disputes involving a correction of assignment of the place of primary use or taxing jurisdiction or refund of or other compensation for taxes imposed or other charges erroneously collected by the home service provider. If a customer

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believes a charge for mobile telecommunications services is incorrect, the customer must provide *written notice* to the home service provider of the contested charge that includes:

1. the customer's account name and number,
2. the street address for the customer's primary place of use,
3. a description of the contested charge, and
4. other information the home service provider reasonably requires to process the notification, as provided on any forms or notices released by a home service provider to its customers regarding its dispute resolution procedure.

The home service provider has 60 days from the date the written notice is postmarked or, if not postmarked, the date of receipt to review the customer's account records and any database or enhanced zip code used pursuant to the MTSA. After the review, the home service provider must determine the correct amount to charge the customer and refund or credit any incorrect charges collected during the previous two years.

This procedure must be followed before any cause of action arising from the dispute may be brought. Customers must show they have reasonably followed the process without success.

RULING:

Mobile telecommunications services include both one-way and two-way wireless communications carried on between mobile stations or receivers and land stations, and by mobile stations communicating among themselves. Mobile telecommunications may include but are not limited to:

- wireless local and interstate telephone service,
- paging services,
- two-way radio service,
- directory information,
- call forwarding,
- caller identification,
- call-waiting,
- broadband personal communications services,
- wireless radio telephone services,
- geographic-area specialized and enhanced specialized mobile radio services, and
- incumbent-wide area specialized mobile radio licensees.

Pursuant to the MTSA, Arizona imposes transaction privilege tax on the intrastate business of home service providers of mobile telecommunications services according to the customer's place of primary use that is within the home service provider's licensed service area. A customer's place of primary use is the customer's residential street address or primary business location, which is the location at which the customer works.

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Arizona does not tax charges associated with mobile telecommunications services that do not originate and terminate in the state.

If the end user of the services is not the contracting party, the end user of the mobile telecommunications services is deemed the customer for the purpose of determining the place of primary use.

Examples:

1. Jim is an Arizona resident with a mobile telephone. While traveling from his home to Nevada, he places two calls home to his wife in Tempe, one from Kingman, AZ and the other from Las Vegas, NV. Jim's home service provider lists a roaming charge for each call on his monthly bill. The roaming charge for the Kingman-Tempe call is taxable as an intrastate call. The roaming charge for the Las Vegas-Tempe call is nontaxable, because Arizona generally does not tax interstate calls.
2. a. Daphne is a Connecticut resident and a vice president of the Westport, CT branch of ABC Corporation, which is headquartered in Arizona. While in Tucson for a business conference, she places a call on her *personal* mobile telephone to her cousin in Scottsdale. Daphne will not be assessed Arizona transaction privilege tax on this intrastate call because her primary place of use is Connecticut, not Arizona.

b. While still in Tucson, Daphne teleconferenced with some business associates in Phoenix using her *business* mobile telephone. In this case, ABC Corporation will not be assessed Arizona transaction privilege tax. Pursuant to the MTSA, the place of primary use will be the primary business address, which is the street address of ABC's Westport, CT branch at which Daphne, the end user, works, and not the street address of ABC Corporation's Arizona headquarters.
3. a. Andrew enters a mobile telephone contract that charges him one flat rate for 300 minutes to use anytime for long distance or local calls. The charge for the 300 minutes is subject to Arizona transaction privilege tax pursuant to 4 U.S.C. § 123(b). Although Arizona generally imposes tax only on intrastate calls made within the state, because the charges for any long distance or otherwise nonqualifying calls placed are aggregated with charges for the intrastate calls, the charges for nontaxable services are subject to taxation unless the home service provider can reasonably identify charges not subject to transaction privilege tax from its books and records kept in the regular course of business.

b. Assume Andrew's usage exceeds the allotted 300 minutes. When he receives his monthly statement, he notes that the home service provider has

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- listed calls he made and charges a per-minute rate for each of the additional minutes over his calling plan. Charges for these additional minutes are taxable only if they are intrastate calls made within Arizona. Charges for additional minutes used for interstate calls are nontaxable. If the home service provider does not break out the charges for additional minutes by intrastate versus interstate calls, the entire amount may be taxable.
4. a. Joshua and Rachel are attending college in New York and Rhode Island respectively. Each has a mobile telephone with a number that is local to his or her college address. All charges are billed to Joshua and Rachel's father residing in Arizona, who is an end user and also the contracting party. The father will pay Arizona transaction privilege tax on charges attributable to his usage as presented in Example 3. No Arizona tax is due on either Joshua or Rachel's usage because they are the end users of their mobile telephone services and are located outside of Arizona's taxing jurisdiction.
- b. Suppose that Joshua and Rachel's services are under a pooled "family plan" with their father, where all three users share 800 minutes that can be used at anytime by any user for local or long distance calls. An aggregated charge for the 800 minutes is subject to Arizona transaction privilege tax, even if the calls placed by Joshua and Rachel using the 800 minutes would not otherwise be taxable, unless the home service provider can reasonably identify charges not subject to tax from its books and records kept within the regular course of business. If the users exceed the minutes in their plan and the home service provider charges per-minute fees for the excess, only the portion of the fees attributable to the father's usage for intrastate calls is subject to Arizona tax.
5. Sandro and Francesca are attending college in California and Arizona respectively. Each has a mobile telephone. All charges are billed to Sandro and Francesca's mother, who resides in Arizona but is not an end user. Arizona imposes transaction privilege tax on Francesca's usage in the same manner as in Example 3. If Sandro and Francesca share pooled minutes that are subject to one charge, however, Arizona may assess transaction privilege tax on the entire charge based on the nexus with end user Francesca, unless the home service provider can reasonably identify charges not subject to tax from its books and records kept within the regular course of business.

Sales of Internet access are nontaxable pursuant to A.R.S. § 42-5064(A)(2). Thus, to ensure proper administration of the transaction privilege tax pursuant to A.R.S. § 42-5023 and in accordance with the MTSA, home service providers must either:

- (c) separately state the portion of their gross income that constitutes the nontaxable Internet access charges, or

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- (d) reasonably identify Internet access charges in its books and records that are kept in the regular course of business.

Where a business is unable to identify a nontaxable sale of Internet access, e.g., as a component of a bundled service offering sold at a flat fee, the gross income derived from the offering will be presumed to be subject to transaction privilege tax.

The MTSA does not apply to prepaid mobile telecommunications, air-to-ground telecommunications, or international mobile telecommunications. Air-to-ground telecommunications means a radio service in which common carriers are authorized to offer and provide radio telecommunications service for hire to subscribers in aircraft. Internet access services that provide a connection to the Internet by means of a dial-up service or dedicated line are not considered mobile telecommunications services. A service provider that furnishes a wireless service via a mobile wireless modem between the customer and the Internet access service provider is providing a wireless communications service. Wireless communications service does not include a prepaid telephone calling service.

Examples:

6. Erica purchases a prepaid subscriber identification module (SIM) card of 300 minutes for her telephone, which utilizes the Global System for Mobile Telecommunications (GSM) network. The sale is not subject to Arizona transaction privilege tax under the telecommunications classification but may be subject to tax under the retail classification under A.R.S. § 42-5061(R).
7. Henry adds two optional services—browser capability and text messaging—to the existing telecommunications services he has with his mobile telephone service provider. Charges for text messaging are taxable. Charges for browsing capability, however, are nontaxable if they merely provide Henry with the ability to connect to the Internet. The MTSA and the A.R.S. do not allow state taxes to be imposed on Internet browser capability charges, for example, that are based on usage time or the size or number of materials downloaded, are not Internet access fees and are subject to transaction privilege tax.

In accordance with A.R.S. § 42-5034.01, a home service provider must provide a “first course of remedy” as statutorily provided to customers disputing a place of primary use assignment or other charges allegedly erroneously collected.

Example:

8. Andrea has been receiving mobile telephone bills for the last six months that assess tax based on an old address in a taxing jurisdiction that imposes a higher tax rate than the jurisdiction in which Andrea currently resides. Andrea

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has called her home service provider repeatedly to correct the discrepancy with no success. She files a claim in justice court for the aggregate amount she believes she should be refunded. Her complaint will be dismissed, because she has not submitted written notification to her home service provider complying with the requirements of A.R.S. § 42-5034.01(B).

J. Elliott Hibbs, Director

Date

Explanatory Notice

The purpose of a tax procedure is to provide procedural guidance to the general public and to department personnel. A tax procedure is a written statement issued by the department to assist in the implementation of tax laws, administrative rules, and tax rulings by delineating procedures to be followed in order to achieve compliance with the law. Relevant statute, case law, or administrative rules, as well as a subsequent procedure, may modify or negate any or all of the provisions of any tax procedure. See GTP 96-1 for more detailed information regarding documents issued by the Department of Revenue.